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SUBJECT: CONSENSUS EMERGING TO RAISE CONSUMPTION TAX TO 10  
PERCENT, SAYS LDP'S YANAGISAWA

SENSITIVE BUT UNCLASSIFIED - PROTECT ACCORDINGLY

11. (SBU) Summary: A domestic business sector consensus is emerging in favor of raising Japan's consumption tax from 5 to 10 percent, and the Japanese people are ready to accept it, according to LDP Tax Policy Committee Chairman Yanagisawa. A Cabinet decision to increase the rate is expected in June, although it will not specify the timing or amount of a future increase. The actual increase is likely to be phased in between 2009 and 2015, Yanagisawa told Embassy EMIN. Yanagisawa did not discuss the potential adverse impact on private demand of a consumption tax increase. End Summary.

12. (SBU) A business sector consensus is emerging in favor of raising Japan's consumption tax to 10 percent from the current 5 percent rate, LDP Tax Policy Committee Chairman Hakuo Yanagisawa told Embassy EMIN on March 16. During a meeting with Yanagisawa the previous day, representatives of the Japan Business Federation (Nippon Keidanren) had advocated increasing the consumption tax at the earliest possible time, citing the fact that Japan's 5 percent consumption tax rate is "extremely low" compared with other OECD countries. Yanagisawa reported hearing similar views from local business circles. Half jokingly he remarked that the only ones who do not share this view are Japanese housewives, who are sensitive to even a one-point increase and would not be won over easily. Nevertheless, he asserted, the Japanese people are prepared for an increase to 10 percent. The only issues to be settled are whether the increase would take place all at once or in stages and whether there would be any exemptions such as food. Yanagisawa said he would favor no exemptions unless the tax is set above 10 percent.

13. (SBU) On the timing of a consumption tax increase, Yanagisawa said that some increase in 2009 was inevitable, as the revision of Japan's Pension Act scheduled for that year would increase the share of basic pensions paid from tax to half from the current one-third. A one-percentage-point increase in the consumption tax rate would be sufficient to cover this additional expenditure, he noted. Yanagisawa's

preference, however, would be to defer any further increase until 2015, the year Economic and Fiscal Policy Minister Yosano is targeting to achieve a primary surplus of 10 trillion yen, about 2 percent of GDP. (Comment: A one-time increase in the consumption tax from 5 or 6 percent to 10 percent would likely have a contractionary macroeconomic impact on 2-3 percent of GDP. End Comment.) Yanagisawa cited 2011 as another possible target, since Yosano is aiming to eliminate the GOJ primary deficit by then, but Yanagisawa said he opposes making staged increases in both 2011 and 2015.

¶4. (SBU) Yanagisawa said he expects a Cabinet decision on a road map for the consumption tax increase in June, but the road map would be silent on the timing of specific measures in order to allow future decisions based on economic circumstances at the time.

¶5. (SBU) Yanagisawa added that the GOJ has not yet agreed on the baseline for annual revenue to use in its fiscal projections. LDP Policy Council Chairman Hidenao Nakagawa and MIC Minister Takenaka favor a rising baseline that reflects Japan's improved economic outlook, while Yosano and Finance Minister Tanigaki prefer a flat revenue baseline.

¶6. (SBU) Comment: As chair of the LDP Tax Policy Committee, Yanagisawa faces competing pressures to address Japan's fiscal challenges while trying to minimize the difficult fiscal choices that Prime Minister Koizumi's (presumably LDP) successor will inherit. Koizumi's promise not to raise consumption taxes during his term, while politically expedient, also reflected the memory of Japan's disastrous 1997 consumption tax hike that, together with the Asian financial crisis and a domestic banking crisis, helped choke off a nascent recovery. Notwithstanding business sector

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support for raising the consumption tax as soon as possible, the timetable Yanagisawa described seems calculated to put off any increase as long as possible. The adoption of a "road map" in June would give Koizumi's successor some breathing room on the consumption tax issue, but the next prime minister will still face politically difficult decisions, as significant spending cuts would be required to achieve a primary balance by 2011 and a 2% of GDP surplus by 2015 without a major increase in revenue. End comment.  
SCHIEFFER